

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

In the Matter of the Protest of)	
)	DOCKET NO. 18036
[Redacted],)	
)	DECISION
Petitioners.)	
_____)	

On February 26, 2004, the staff of the Income Tax Audit Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (taxpayers), proposing income tax and interest for the taxable years 2000 through 2002 in the total amount of \$20,844.

On April 26, 2004, the taxpayers filed a timely appeal and petition for redetermination. The taxpayers did not request a hearing but rather chose to submit additional documentation and information for the Tax Commission to consider. The Tax Commission, having reviewed the file, hereby issues its decision modifying the Notice of Deficiency Determination.

The Income Tax Audit Bureau (Bureau) selected the taxpayers 2000, 2001, and 2002 Idaho individual income tax returns for examination. The Bureau contacted the taxpayers and requested the supporting documentation for a number of items claimed on the taxpayers' returns. The taxpayers provided some of the requested documentation and a narrative explaining their situation. The Bureau reviewed the information provided and requested additional information and documentation. The taxpayers failed to provide any additional information. The Bureau adjusted the taxpayers' returns based upon the information available and sent the taxpayers a Notice of Deficiency Determination.

The taxpayers protested the Bureau's determination and provided additional information and documentation for the Bureau to consider. The Bureau reviewed what the taxpayers provided and made modifications to its deficiency determination. The Bureau sent the modifications to the taxpayers and asked if they agreed with the revised deficiency

determination. The taxpayers did not respond. Therefore, the Bureau referred the matter for administrative review.

The Tax Commission reviewed the matter and sent the taxpayers a letter giving them two options for having the Notice of Deficiency Determination redetermined. The taxpayers responded that they would provide additional information for consideration. On December 14, 2004, the taxpayers provided additional documentation and a letter of explanation to be included in the redetermination. The Tax Commission reviewed that information in conjunction with the information previously provided. The Tax Commission determined additional information was needed, so the Tax Commission sent the taxpayers a letter asking them to provide some specific information. After nearly a year since the Tax Commission asked for the specific information and following up from time to time with telephone calls and a final request letter with no response from the taxpayers or their representative, the Tax Commission decided the matter based upon the information available.

Mr. [Redacted] is a Certified Registered [Redacted] with a practice in [Redacted] and [Redacted]. Mrs. [Redacted] is a [Redacted] who works off and on but is primarily retired. The taxpayers have a house in [Redacted], Idaho and [Redacted], Florida. It is unknown when the taxpayers purchased the house in Florida or when they first started going to Florida, but for at least 2000 and 2001 the taxpayers stated they were residents of Idaho. Mr. [Redacted] is a member of two Idaho Limited Liability Companies (LLCs) and a partner in one Idaho partnership. He derives most of his income from one of the LLCs. He reported that income on a schedule C – Profit or Loss From Business. Mr. [Redacted] reported various expenses on the schedule C reducing his flow-through income from the LLCs. The Bureau asked for verification of the expenses claimed but received very little from the taxpayers. The Bureau's initial

adjustment to the taxpayers' schedules C for the three years was to disallow nearly all the claimed expenses.

In addition to the schedule C adjustments, the Bureau made adjustments to income for unreported interest and an unreported sale; adjustments to the taxpayers' itemized deductions; adjustments to the self-employed health insurance deduction; and adjustments to the simplified employee pension (SEP) deduction. Of these adjustments, the taxpayers conceded the adjustments for the additional interest income, the self-employed health insurance deductions, the itemized deductions adjustment for taxes, and the penalty on the early withdrawal of savings. The Bureau conceded or modified the adjustment on the unreported sale based upon information the taxpayers provided and allowed additional expenses on the schedules C. The remaining issues to be determined are various schedule C expenses including interest, vehicle expenses, travel expenses, rent, repairs, and utilities; interest claimed as an itemized deduction; and additional contributions to a SEP.

Internal Revenue Code section 162(a) states in part, that "[T]here shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business." However, deductions/expenses are a matter of legislative grace and only as there is clear provision therefor can any particular deduction be allowed. New Colonial Ice Co., Inc. v. Helvering, 292 US. 435, 54 S.Ct. 788 (1934). The petitioner bears the burden of proving that he is entitled to the deduction. Higgins v. C.I.R., T. C. Memo. 1984-330 (1984). The burden rests upon the taxpayer to disclose his receipts and claim his proper deductions. United States v. Ballard, 535 F.2d 400 (1976).

The taxpayers claimed expenses on their schedules C for travel, meals, rents, interest, legal and professional fees, office expenses, office supplies, repairs and maintenance, insurance,

utilities, and kennel storage. The taxpayers provided little or no documentation to the bureau to support these expenses. At the time of the appeal and when the Tax Commission made the same requests, the taxpayers stated their records were destroyed in the flooding that occurred from the recent hurricanes in the Florida area (calendar year 2005). If a taxpayer is unable to provide adequate proof of any material fact upon which a deduction depends, no deduction is allowed and that taxpayer must bear his misfortune. Burnet v. Houston, 283 U.S. 223, 51 S.Ct. 413 (1931). However, Treasury Regulation section 1.274-5T(c)(5) makes provision for expenses relating to travel, entertainment, gifts, and listed property where the loss of taxpayer records were due to circumstances beyond the control of the taxpayer. The taxpayer must establish that the failure to produce adequate records was because of circumstances beyond the taxpayer's control, such as destruction by fire, flood, earthquake, or other casualty. If this is shown, the taxpayer has the right to substantiate a deduction by reasonable reconstruction of his expenditures or use of property.

The taxpayers stated their records were destroyed when their Florida house was flooded in the wake of the hurricanes of 2005. The taxpayers provided no evidence of the flood damage that occurred as a result of the hurricanes; however, knowing the location of the taxpayers' house, it is reasonable to assume they suffered some water damage from the hurricanes. Therefore, the Tax Commission provided the taxpayers with the opportunity to provide additional information that would support the deductions claimed.

To support the expenses related to travel, meals, and entertainment, the Tax Commission wanted explanations of the business use of the motor home the taxpayers used to travel between Idaho and Florida; details of Mr. [Redacted]'s business practices in Florida; and why the taxpayers used an RV rather than flying when traveling by RV consumes a fair amount of time

that could be spent on the job, if the travel was purely for business purposes. The taxpayers failed to provide any additional information. Consequently, the Tax Commission determined the primary use of the motor home was personal and, without any way to determine a business use percentage, no expenses are allowed for travel, meals, and entertainment.

The taxpayers claimed mortgage interest on their schedules C. The Tax Commission asked them to provide an explanation of what was purchased to incur the interest expense. The taxpayers did not provide that explanation; however, from other information provided, it appears that the interest is on the purchase of the motor home. The taxpayers did argue that the motor home qualified as a second home for the interest deduction on schedule A – Itemized Deductions.

Clearly, Internal Revenue Code section 163 allows for the deduction of mortgage interest on a qualified residence of the taxpayers and one other residence. It is equally clear that a motor home could qualify as the other residence. However, it is not clear that the taxpayers intended the motor home to be their one other residence. The taxpayers' principal home or residence was in [Redacted], Idaho. The taxpayers also had a house in [Redacted], Florida. It is not clear from the taxpayers' returns or from any documentation or explanation provided by the taxpayers which property was claimed as a second residence. In addition, the taxpayers have not established a business purpose or use of the motor home to qualify it as a 100 percent business asset for the purposes of an interest deduction on schedule C. Therefore, the Tax Commission finds the unsubstantiated amounts claimed as interest on schedules A and schedules C are not allowable.

Other expenses claimed on the taxpayers' schedules C that the Tax Commission requested further explanation or information on were utilities, rent, repairs and maintenance, and kennel storage. Mr. [Redacted] stated that he had an office in his home, but he did not claim any office-in-

the-home expenses. Most of these expenses could relate to an office somewhere but again the taxpayers provided no information on these expenses. Some of the expenses could be associated with the use of the motor home, and, as previously stated, no expenses related to the motor home are allowable. Since the taxpayers failed to provide any information on these expenses, they have failed to meet their burden of proof. United States v. Ballard, supra. Therefore, the Tax Commission upholds the Bureau's disallowance of these expenses.

The Bureau made adjustments to the taxpayers' SEP contributions. The adjustments made were based upon a computation of the limitation applicable to the contributions to the SEP. The Bureau's computation was based upon an estimated contribution rate. The taxpayers did not specifically contest the Bureau's computation; however, they did argue that an additional amount needed to be included as a contribution, and they provided documentation showing the additional amount contributed. So in essence, the taxpayers disagreed with the Bureau's computation of the limitation to the contributions to the SEP.

In reviewing this adjustment, the Tax Commission saw some problems on both sides. The Bureau, in determining the contribution rate to the SEP, estimated the rate. For a SEP to be a qualified plan, the contribution rate must be specified in the plan. That rate is used in the computation of the limitation for the maximum deductible amount contributed to the SEP. Without the plan's specified rate, the computation of the limitation is at best a guess and an adjustment based upon an incorrect limitation is simply in error. On the other side, the taxpayers provided documentation that shows contributions to a retirement account for Mr. [Redacted] by his employer, presumably these are contributions to the SEP. However, it is not clear from this documentation whether the amounts contributed are included in the amount stated as being contributed on the K1 Mr. [Redacted] received from his LLC/employer. Therefore, based upon the

information available or, more appropriately, the lack of information, the Tax Commission finds that the allowable contributions to the SEP are the amounts identified on the K1s received from the LLC.

WHEREFORE, the Notice of Deficiency Determination dated February 26, 2004, is hereby MODIFIED in accordance with the provisions of this decision and, as so modified, is APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayers pay the following tax and interest:

<u>YEAR</u>	<u>TAX</u>	<u>INTEREST</u>	<u>TOTAL</u>
2000	\$ 3,236	\$ 1,061	\$ 4,297
2001	4,083	1,024	5,107
2002	8,170	1,523	<u>9,693</u>
		TOTAL DUE	<u>\$19,097</u>

DEMAND for immediate payment for the foregoing amount is hereby made and given.

An explanation of the taxpayers' right to appeal this decision is included with this decision.

DATED this ____ day of _____, 2006.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2006, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[REDACTED]

[REDACTED]

Receipt No.
